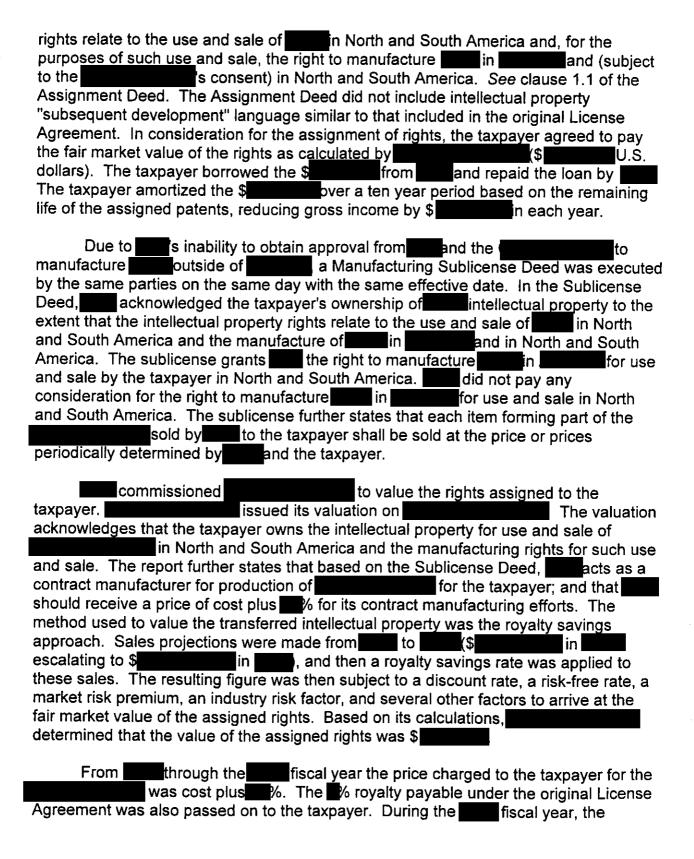
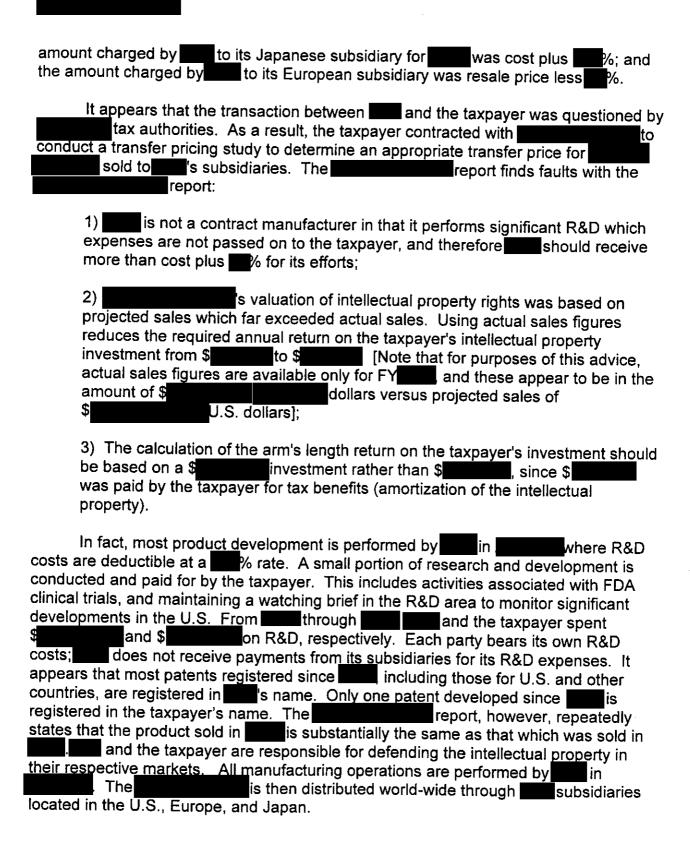
Office of Chief Counsel Internal Revenue Service memorandum

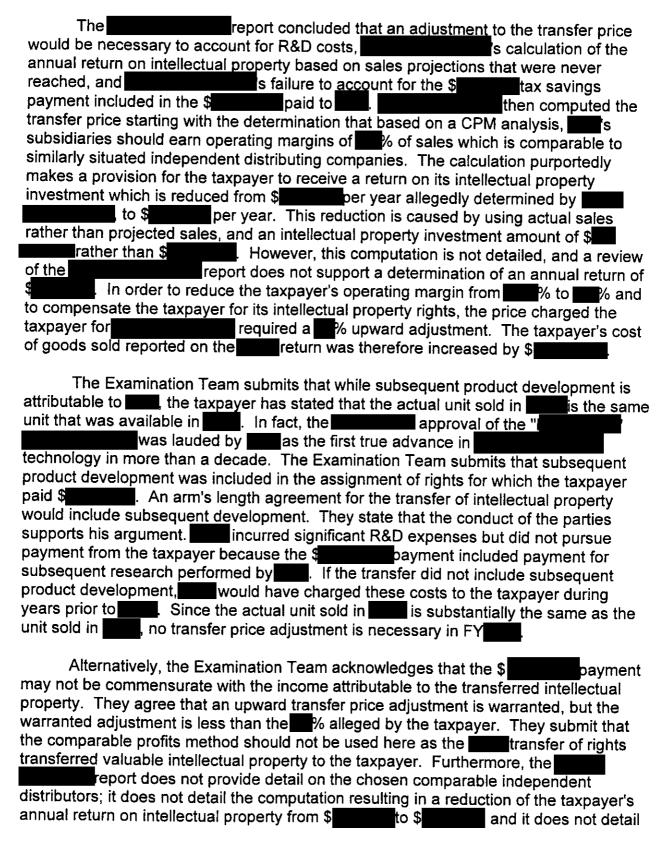
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date:				
to:	Linda Novak, Manager International Group E:2:15			
from:	District Counsel, Denver			
subject:				
	Your office has requested advice regarding intellectual property rights transferred in			
	ISSUES			
ı Î	1. What intellectual property did ("the taxpayer") acquire in from its parent corporation, which is property have value in the sold by to the taxpayer during the fiscal year ending? ("the taxpayer") acquire in the property have on the transfer price to the taxpayer during the fiscal year ending?			
	2. What is the tax affect of the consideration of \$paid by the taxpayer for the intellectual property?			
	CONCLUSIONS			
	1. In the taxpayer acquired intellectual property rights relating to the use and sale of the North and South America and, for the purposes of such use and sale, the right to manufacture in and (subject to approval) in North and South America. The rights acquired included subsequent developments made by the and the and the and the and the subsequent developments made by the taxpayer have significant value in as the sold in sold in the substantially the same product as that which was sold in the taxpayer by as Based on the substantially the taxpayer's intellectual property.			

2. Payments for intellectual property rights relating to the royalty payments under Article of the United States Income Tax Treaty which are subject to withholding under I.R.C. § 1442.
FACTS
The was initially developed by the and the consists of the and the and a and a A programming device, the is a related piece of equipment used by to individually program the patient's is a related piece of equipment used by specific market, the namely children and adults for whom are of little or no value.
On and the and the executed a License Agreement with ("""), where at Clause 2.1:
and the hereby grant to the exclusive right and authority and license to the know-how and licensed patents described in the annexed Schedule 'A' (including utility models, patents of addition, and patents of importation, and patents of confirmation corresponding to said licensed patents and to any and all continuing and divisional applications and extensions and reissues thereof and any foreign equivalents thereof) to manufacture and in and subject to Clause 2.3 outside and to use and sell and in all countries of the world.
The License Agreement provided that subsequent developments made by or the would be included within the scope of the license. In consideration for the license, agreed to pay royalties to and the equal to percent of the royalty base (roughly net sales price to unrelated third-parties) for the first units sold and thereafter percent on each unit sold.
On and and a land and a land and a land a la
On an Assignment Deed (effective substitution), was executed by the theorem and the substitution of the date of the assignment, were transferred to the taxpayer to the extent that these







Finally, the Examination Team contends that the \$ dollar payment is a royalty payment under Article of the dollar payment. United States Income Tax Treaty, and is subject to withholding under I.R.C. § 1442.

ANALYSIS

Intellectual Property and Transfer Pricing

Internal Revenue Code section 482 states:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Treasury Regulation § 1.482-4 provides methods to determine taxable income in connection with a transfer of intangible property. Section 1.482-4(a) states:

The arm's length amount charged in a controlled transfer of intangible property must be determined under one of the four methods listed in this paragraph (a). . . The available methods are--

- (1) The comparable uncontrolled transaction method;
- (2) The comparable profits method;
- (3) The profit split method; and
- (4) Unspecified methods described in paragraph (d) of this section.

Regulation § 1.482-4(f) provides special rules for transfers of intangible property. Specifically, §1.482-4(f)(3)(ii) provides rules to identify the owner of an intangible.

Subsection (A) states:

The legal owner of a right to exploit a legally protected intangible ordinarily will be considered the owner for purposes of this section. Legal ownership may be

acquired by operation of law or by contract under which the legal owner transfers all or part of its rights to another.

Subsection (B) states:

In the case of intangible property that is not legally protected, the developer of the intangible will be considered the owner. . . . Ordinarily, the developer is the controlled taxpayer that bore the largest portion of the direct and indirect costs of developing the intangible, including the provision, without adequate compensation, of property or services likely to contribute substantially to developing the intangible.

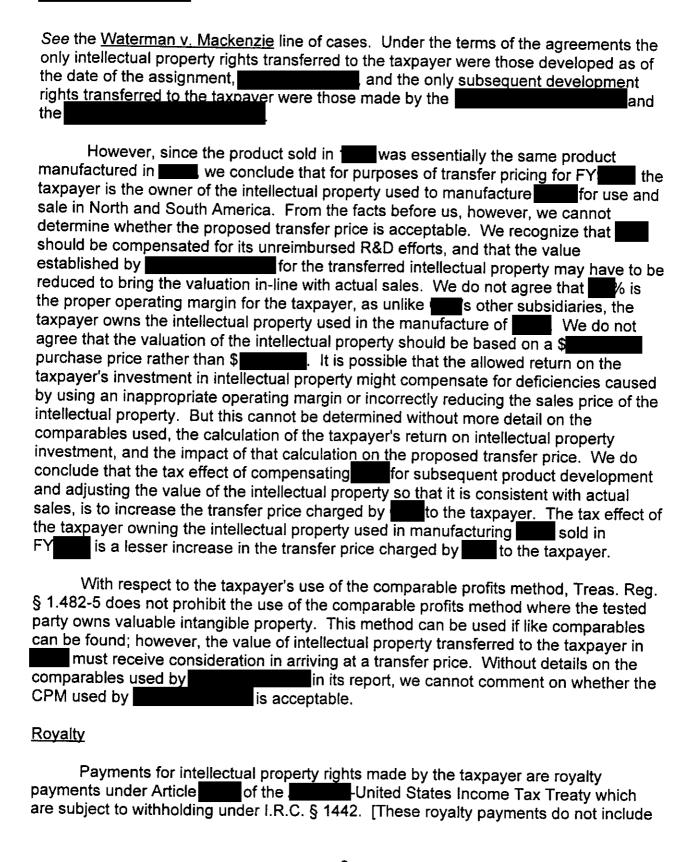
Under the doctrine of indivisibility, a contract conveying the exclusive right to make, use and vend an invention in the United States or within a specified area constitutes an assignment of the patent, and any transfer short of that is not an assignment but a license. <u>Dairy Queen of Oklahoma v. Commissioner</u>, 250 F.2d 503, 506 (10th Cir. 1957). See also <u>Waterman v. Mackenzie</u>, 138 U.S. 252, 11 S.Ct. 334, 34 L.Ed. 923 (1891); <u>Watson v. United States</u>, 222 F.2d 689 (10th Cir. 1955); <u>Taylor-Winfield Corporation v. Commissioner</u>, 57 T.C. 205 (1971).

Regulation 1.482-5 describes the comparable profits method. The comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. Section 1.482-5(a)(b)(2) states that:

For purposes of this section, the tested party will be the participant in the controlled transaction whose operating profit attributable to the controlled transaction can be verified using the most reliable data and requiring the fewest and most reliable adjustments, and for which reliable data regarding uncontrolled comparables can be located. Consequently, in most cases the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

Regulation 1.482-1(c)(1) states that the transfer pricing result must be determined under the method that provides the most reliable measure of an arm's length result.

In the present case, we	e conclude, and the taxpayer agrees, that the
Assignment Deed transferred	intellectual property rights relating to the use and sale of
	erica and, for the purpose of such use and sale, the right to
manufacture in	and (subject to approval) in North and South America.



the original royalty included in the price charged by to the taxpayer.] Article of the treaty defines royalties, in part, to mean:

[P]ayments or credits of any kind to the extent to which they are consideration for the use of or the right to use any: (i) copyright, patent, design or model, plan, secret formula or process, trademark or other like property or right; and (ii) industrial, commercial or scientific equipment.

Article of the treaty includes as royalties:

[P]ayments or credits of any kind to the extent to which they are consideration for: (i) the supply of scientific, technical, industrial or commercial knowledge or information owned by any person; and (ii) the supply of any assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of knowledge or information referred to in sub-paragraph (b)(i) or of any other property or right to which this Article applies.

Since the consideration paid by the taxpayer to was, in part, for the right to use property covered under the treaty, the amounts paid for the right to use this property represent royalties subject to withholding under I.R.C. § 1442.

If you have any questions regarding this memorandum, please contact Mark S. Heroux at (303) 844-2214 ext. 225.

	District Counsel	
Ву:		
	JERRY L. LEONARD	
	Assistant District Counsel	

MARTIN B. KAYE

Attachments:

Examination Field Service Advice Request with Exhibits

Exhibit A: Group Structure

Exhibit B: License Agreement and Deed of Novation

Exhibit C: Assignment Deed

Exhibit D: Valuation
Transfer Pricing Report

Manufacturing Sublicense Deed